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IFRS 11- Joint Arrangements: A Review of Literature on Migration from IAS 31 to IFRS 11

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Abstract:
The transition from IAS 31- Interests in Joint Ventures to IFRS 11- Joint Arrangements leads to the elimination of the Proportionate Consolidated Method and leaves the users in the jointly controlled arrangement to use only the Equity Method. The decision to change from IAS 31 to IFRS 11 was justified by the IASB that the change would lead to improved comparability of accounting prepared by joint venturers, and there were limitations from the use of the proportionate consolidated method compared to the equity method. Several letters were written to the IASB during the exposure draft stages on the need for IASB to suspend the implementation of IFRS 11, but IASB went ahead. IASB conducted the Effects Analysis and later released IFRS 12 – Disclosure of Interest in other Entities to address some of the concerns raised by stakeholders. Other researchers have conducted several studies to show the benefits of the proportionate consolidation method over the equity method. Our findings from this study revealed that IASB hurriedly implemented IFRS 11 with the primary aim of satisfying convergence with US-GAAP without considering the impacts of the changes on the users. The study recommended that IASB should consider all the feedback during the exposure stage while amending or replacing, or issuing a new standard in the future. Also, the inputs from financial analysts and users should be seriously considered since they regularly use the standards for analysis or preparing their financial statements.

Keywords: *Joint arrangements, joint ventures, joint operations, jointly controlled entities, rights and obligation*

1. Introduction

International Accounting Standards Board (IASB) has issued, amended, replaced, or outright discontinued accounting standards and policies to streamline the universality of accounting practices, measurements, and reporting of financial information. Leitner-Hanetseder and Stockinger (2014) stated that the International Accounting Standards Board released IFRS 11, called joint arrangements, to replace the existing standard governing joint venture operations- IAS 31, called Disclosures of Interest in Joint Ventures. The European Union agreed to its implementation in 2012, and all the European companies operating joint ventures, effective from 1st January, 2014, adopted in preparing their financial statements to improve quality financial reporting. According to Demerens et al. (2014), shortly after IASB issued IFRS 11, IASB released a document providing an effective analysis of the new standards IFRS 11 and IFRS 10 (IASB 2011a) as justification for the migration. Demerens et al. (2014) situated the basis for which IASB premised their reasons for the abolition of choice of treating Joint arrangement as evidence from empirical effect analysis, an overview of joint venture activities, cost benefits analysis, and US GAAP convergence issue.

Leitner-Hanetseder and Stockinger (2014) claimed that the main driving factor why the Proportionate Consolidation Method was abolished in favor of the Equity Method is to fulfill the convergence objective with US-GAAP, which currently permits the equity method in accounting for joint ventures operations. Ašenbrenerová (2015) also stated that one of the significant changes was prohibiting the options users had under IAS 31, whether to use equity method or proportionate consolidation method for joint ventures to the permission of only equity method under the new standard IFRS 11 Joint arrangement.

IASB (2011) released a statement shortly after the issuance of IFRS 11 for replacement of IAS 31 that the existing structure was the major determinant of joint arrangement and the liberty or freedom companies have while selecting which method to be used while reporting in jointly controlled ventures. IFRS 11 was introduced to remedy shortcomings of IAS 31 by setting up a framework that will guide treatments of all joint arrangements-based types of joint arrangements being operated on the basis of underlying rights and obligations in the joint arrangement. Demerens et al. (2014), in responding to criticism letters received by IASB during the Exposure Draft stages on the migration from IAS 31 to IFRS 11, stated that it is essential for IASB to take note that introducing a new accounting standard or even updating an existing standard will always have effects or consequences and the effects or consequences are likely to affect many stakeholders in the process.

According to Gobbo (2017), although IASB is silent on its feedback, a project summary on convergence with US-GAAP is the main objective for the issuance of IFRS 11 in replacement of IAS 31 for accounting for joint venture operations. Though the IASB subtly affirmed that the earlier goal was convergence, the main goal was to improve the shortcomings

IAS 31 could not resolve in accounting for joint operations. It has caused many drawbacks in reporting quality financial reports while accounting for joint entities due to the reporting structure and options to choose from while reporting. Based on the opinion of Gobbo (2017), IASB clearly stated that the major concern for the introduction of the changes in the joint arrangement was addressed by the two highlighted weaknesses observed to exist under IAS 31. According to the IASB belief, the identified limitations for the changes in IAS 31 to IFRS 11 could lead to a situation where the same rights and obligations could be accounted for differently due to the freedom to determine the accounting methods to be used by reporting entities.

However, this article will review different empirical perspectives, from transiting from liberty to choose a method for reporting joint operations or arrangements from the Equity Method or Proportionate Consolidation method to the only permitted method under IFRS 11, which is the equity method. Demerens et al. (2014) stated that the reported effects highlighted by the IASB in their effect analysis are less than the actual effects caused by the transition on the consolidated financial statements of the joint operators.

2. Review of Literature

2.1. Joint Arrangements

According to IASB (2011), Joint Arrangement can be defined as a situation where one or more parties have joint control over a jointly owned entity, and they are to oblige to all contractual arrangements that clearly spell out the rights and obligations of all parties under the jointly controlled operations or ventures. According to Leitner-Hanetseder and Stockinger (2014), the IASB released IFRS 11 to remedy the shortcomings or weaknesses found under IAS 31, and this transition has brought some changes in the known concepts and terminologies we were familiar with under the previous standard. Lüdenbach (2011), in an attempt to justify the position of IASB from transiting from IAS 31 to IFRS 11, stated further that it is not about a change in name alone, but the contents and scope under the new standards that are clearer to the users and all stakeholders now.

2.2. Joint Ventures

According to IASB (2011), investment in a joint venture or interest shall now be reported in line with the position of IAS 28 (Investment Associates and joint Ventures) using the permitted method of reporting now, which is the equity method. However, if the parties to a joint venture or joint arrangement do not have control, they will have to report or account for their investment in line with IFRS 9, Financial Instruments, except if there is a significant influence or otherwise in line with IAS 28 as amended in 2011. Under the new IFRS 11 using the equity method, joint venturers with joint control will now have rights to the net assets of the joint arrangement. In the work of Hannula and Kari (2007), accounting for joint ventures is very difficult due to varying interests and objectives by investors due to various strategic motivating factors to invest in joint operations. Hence, the need to formalize the joint ventures through detailed agreement about parties' rights and obligations becomes imperative under the joint arrangement for easy reporting and accountability.

2.3. Joint Operations

According to IASB (2011), a joint operation is a situation where two or more parties set up a joint arrangement that is jointly controlled through the rights to the assets, liabilities, and contractual obligations of all parties under the joint arrangement. Gavana, Gottardo, and Moisello (2020) stated that the joint arrangement should consider the economic substance in accounting for the parties' rights, obligations, assets, and obligations under the joint operations. However, the parties can account for their investment line by line while using a proportionate consolidated method or have the rights to net assets while accounting for a joint arrangement under the equity method.

2.4. Joint Control

Lehonoksa (2016) stated that joint control is when parties to a joint arrangement have a jointly and contractually binding agreement with respect to sharing of control, which takes significant decisions with respect to the activities of a joint arrangement. The definition of Lehonoksa (2016) is in accordance with the characteristics of joint control in IFRS 11, which are:

- What determines relevant activities and rights, and
- What level of consent is required before a major decision is taken in the joint arrangement

2.5. Rights and Obligations

IASB (2011) explained rights and obligations as a situation where an entity applies judgment while assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement, and, when relevant, other facts and circumstances as contained in paragraphs B12–B33. Sometimes the parties are bound by a framework agreement that sets up the general contractual terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might differ if the parties' rights and obligations differ while undertaking the different activities they deal with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities forming the same framework agreement.

Leitner-Hanetseder and Stockinger (2014) stated that contrary to IAS 31, in which the legal form of the arrangement was the primary determinant for the classification, IFRS 11 defines the rights and obligations of the involved parties as the central criteria. Haaramo et al. (2015) stated that ownership of the parties differs between a limited liability company and its shareholders. In contrast, owners are all personally liable for any legal actions and debts the company may face relating to a general partnership. Consequently, when there are no other factors considering terms of contractual arrangement or other facts and circumstances, a joint arrangement can be classified as a joint venture (limited liability company) or joint operation (general partnership).

2.6. Contractual Arrangements

According to IASB (2011), the basis for contractual arrangement rests on the structure, content, and vehicle of the legal arrangement, usually in writing or otherwise. However, all elements of a valid contract will be entrenched in the contract and are enforceable under the law by all parties that are concerned under the joint arrangement. However, when a joint arrangement is structured through separate special vehicles, the contractual arrangement will be incorporated in the article of the association, charter, or in line with the standards or law guiding their operations in that environment. However, the contractual arrangement spells out the conditions under which all parties to the joint arrangement will operate with respect to the purpose, activity, capital contribution, right to borrow, duration, the composition of the board, the share of profit, decision-making rules, the appointment of auditors and solicitors and ultimate dissolution of the joint arrangement voluntarily by the parties or technically by operations of law.

2.7. Empirical Review of Changes from IAS 31 to IFRS 11

Gavana, Gottardo, and Moisello (2020) stated in their position against the position of IASB for abandonment of proportionate consolidation method for equity method in Joint Arrangement, and the new standard has abolished the liberty available to joint venturers to choose the preferred method in accounting and reporting for joint operations which the new standard has restricted them to the choiceless option of the equity method of reporting in joint operations. Gavana et al. (2020) stated further that the transition decision of IASB from IAS 31 to IFRS 11 was not supported by the available accounting literature, which is yet to concur with the supreme argument that the equity method benefits outweigh the proportional consolidated method of reporting joint arrangement. Moreover, the position of Alexander et al. (2012) is not different from the stance of Gavana et al. (2020) by saying that most of the responses received during the IASB Exposure Draft ED 9 in 2007 did not show a preference for equity method over proportionate consolidation method.

Gavana et al. (2020) stated that the effect analysis conducted by IASB to assess the impact of the new standard was restricted to five industries and nineteen companies using the proportionate consolidation method to account for joint ventures with a limited effect on the co-venturers financial statement. It was not an adequate conclusion, and the basis of IASB to adopt the equity method as the preferred choice is different from their own empirical research, which considers ex-ante and ex-post effect analysis.

Graham et al. (2003) stated that while predicting future returns in joint operations, the proportionate consolidated is the preferred accounting treatment choice. The position of Graham et al. (2003) is also consistent with the position of Kothavala (2003) that risk relevance and price volatility are being considered in joint operations, and the proportionally consolidated financial statements method is an option to go with over equity method. Ašenbrenerová (2015) did say in another for IASB to address some of the further issues researchers claim after the implementation of IFRS 11 led to the introduction of IFRS 12, which is to address additional disclosure requirements for joint operations and associates. Ašenbrenerová (2015) further stated that IFRS 11 would improve financial statements comparability across various users in different climes. However, some researchers did not agree with this view. Among them are Dieter and Wyatt (1978), who believed that proportionate consolidation shows a better and more robust view of an entity's financial position with reference to its current risks and rewards.

Laurenco et al. (2012) claimed that the equity method deprived investors of information with respect to assets and liabilities. Richardson et al. (2012) revealed that restriction to equity method while reporting financials will have implications on value-relevance though the additional disclosure under IFRS 12 may reduce the costs of choice. In contrast, Catuogno et al. (2015) argued that the inclusion of jointly controlled assets and liabilities vis a vis the claim that there is no theoretical basis for including jointly controlled assets and liabilities with those liabilities and assets as promoted by other researchers has no theoretical basis.

Ašenbrenerová (2015) stated the major reason for the issuance of IFRS 12 (Disclosure requirements about Joint Ventures and Associates) was to address concerns arising from the replacement of proportionate consolidation method and comparability of accounting reporting will be enhanced, and this will not lead to information loss. Bala (2013) adoption of IFRS 11 and IFRS 12, respectively have adequately taken care of the issues previously being addressed by the local GAAP SAS 28 and SAS 29, which deal with investment in associates and interest in joint ventures. Bala (2013) stated that:

- Most of the operations in the upstream Oil and Gas Sector of Nigeria fall under the newly introduced joint arrangements-IFRS11,
- The impacts on their operations will be between renegotiation and review of existing JV arrangements, and
- Production Sharing Contracts (PSCs) and explorations activities will be between Nigeria National Petroleum Corporation and International Oil Companies

EY (2011) expressed an opinion that is subsequent to the introduction and anticipated full implementation of the new standard. The reporting for joint arrangement will now preoccupy themselves with a review of existing contractually binding agreements about joint control operations and who now takes most relevant decisions with respect to a joint arrangement**.** PWC (2011) further expressed a similar opinion that new skills will be required in oil and gas industries on guidance on sharing the higher risks and costs that are peculiar to that industry.

Lehonoksa (2016) opined that since joint arrangements in accounting and reporting are dynamic and constantly changing in the business world, there is a need to have a proactive and dynamic approach to the issue that may come up from joint arrangements by stakeholders, academia to enable them to deal with topical issues in accounting to the presentation of fair view in auditing.

Gobbo (2017) disagreed with IASB over the reference of the Equity Method above the Proportionate Consolidation Method. The justifications for the choice were neither adequately empirically verified nor did IASB clearly show any basis for the choice. Gobbo (2017) stated further that IASB, based on a few types of research carried out, did not show how the transition will benefit the stakeholders and the users of financial information better than the previous positions where users have the choice to report joint arrangement. Gobbo (2017) aligns his position with other researchers like Demerens et al. (2012) that the major drive of IASB to transit from IAS 31 to IFRS 11 was to satisfy the constituents' interest rather than empirically justified reasons for the change. The topic has not been exhaustively debated among practitioners, academia, and users in the international space.

Gobbo (2017) referred to The G4 + 1 report, which added an additional method called the expanded equity method in accounting for joint arrangement in addition to earlier popularized methods which canvassed for the use of the equity in accounting for a joint venture with addition more disclosures to enable parties to a joint arrangement to know what portions of assets and liabilities, income and expenditure, profit or loss and rights and obligations are being shared among them. According to Gobbo (2017), IASB has been crediting the report of G4+1 as one of the bases for transiting from the permission of methods in presenting accounting for joint ventures to only restricted and permitted equity methods under IFRS 11.

Demerens et al. (2014) and Saccon et al. (2012) put the same position forward the effect analysis carried out by IASB was not robust with respect to sample size, and the conclusion arrived at is not sustainable based on several criticisms on the number of companies and countries selected for the study. Gobbo (2017) referred to the work of other researchers who criticized IASB on an empirical basis for changing methods like Saccon et al. (2012). They stated that the sample used by IASB in their effect analysis violated homogeneity of variance, queried the results coming from the IASB's empirical analysis and affirmed that they are not reliable since the sample used is not homogeneous and the industries used for analysis are too small compared to standards that will be used globally. Gobbo (2017) brought out other similar studies in which their findings contradict the view and position of IASB with reference to their conclusion and findings on the Effect Analysis carried discussed the findings of critics of IASB who conducted empirical research to evaluate Effect Analysis.

Some of the other researcher's findings, as put forward by Gobbo (2017), are from Demerens et al. (2014) and Saccon et al. (2012), who conducted similar studies on an extended basis with a more robust sample that covered a wider scope of indices on joint arrangement financial statements compared to the IASB Effect Analysis. Leitner-Hanetseder and Stockinger (2014) conducted a similar study with a different approach using a Cross-Sectional Analysis to carry out their own Effect Analysis by using 350 Companies from Europe. Their studies revealed the following:

- That the change from proportionate consolidated method to equity method indicated it has a significant effect on the total assets, which is more than 5% significant level
- The transition also significantly affects the major financial ratio such as profit margin, EBIT, Net Income, ROE as percentage of EBIT/Shareholders fund, Assets Turnover
- However, in conclusion, the effects vary from industry to industry, and the effect in a single firm may be stronger and lower in another firm. They all conclude that both methods will still give the same results when considering net income and shareholders' equity

Sarquis and Dos Santos (2018) stated that despite receipts of 61% of non-favorable responses by IASB during the Exposure Draft stages on the prohibition of a proportionate consolidated method, the board still went ahead to implement the change from the Proportionate consolidated method to only equity method while accounting for joint arrangements. Sarquis and Dos Santos (2018) stated that for IASB to justify their position despite the quantum of over 61% of do not eliminate, they put premise their decision on the following:

- That the proportionate consolidation method did not align with the definitions of assets and liabilities as explained in the conceptual framework
- That the notes provided in the financial statements will take care of all information previously provided by the proportionate consolidation method

Sarquis and Dos Santos (2018) expressed, based on their research, that the transition from the proportionate consolidation method to the equity method will affect the value presented by the investor. This impact was very clear based on the Brazilian market, where all the entities prepare their financial statement using the proportionate consolidation method.

3. Conclusion and Recommendations

Based on different empirical findings, letters from stakeholders disagreeing with IASB during Exposure Drafts 7 and 9 on the need not to abolish the use of proportionate consolidation method when treating transactions arising from

Joint Arrangement. However, the introduction of Effects Analysis by IASB is a welcome development but there are other recommendations by various researchers listed below:

- Due to the small sample size of IASB Effect Analysis, more robust empirical studies across different industries in various geopolitical zones should be carried out in the future when standards are being amended or replaced or freshly issued
- IASB did not directly engage any companies engaging in joint arrangements by ways of questionnaires or interviews for detailed feedback or suggestions before deciding to migrate from IAS 31 to IFRS 11, and this should be considered in future
- Financial Analysts and Academia should be seen as users, and their input should be given serious consideration during the Exposure Draft stage.

This review faced some limitations listed below:

- Scarcity of articles and academic journals on this topic in Nigeria and Africa
- Most of the available articles were mainly on European Companies.

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